Volume XVI

JANUARY 29
1947

Number 2

As I see it

THE EFFECT OF MONETARY INFLATION ON REAL ESTATE

THREE bulletins we have published recently have caused considerable excitement among insurance companies, banks and real estate operators. These were the "As I See It" Bulletin headed An Investment Policy, the forecasts I made in the July Executive Digest on the cost of building our standard six-room frame residence each year from now until 1955, and the Appraisal Bulletin by Mr. Kissack of our organization called The Buyer in a Seller's Market. All of these bulletins expressed the belief that replacement cost was very close to the peak and that in succeeding years it would be possible to build identical buildings at a considerably lower cost than the costs experienced today. They also indicated that the high scarcity premium which has been paid for residential properties during the last few years is shrinking fast and would entirely disappear within the next few years, with a resulting shrinkage in market price on the average residential property, imperiling many loans made on a high percentage of the market price.

We have received requests from large institutions for many hundreds of extra copies of these bulletins to be distributed to their officers and members of their boards of directors. We have received many comments from all over the country, many of them agreeing, some doubtful, and a few openly antagonistic. We have been asked whether a drop in price would be possible in view of the inflated currency and credit situation. Our assumption that values would drop by a considerable amount in the next ten years has not seemed reasonable to many persons who are convinced that the size of the government debt and the inflation of currency and credit have permanently raised the price level in the United States by the percentage that the dollar was inflated.

It is only recently that I have turned from an inflationary attitude in my forecasts to a deflationary one. So long as the OPA was in existence and received a modicum of popular support, I believed that prices would constantly go higher due to a demand strongly in excess of supply. This extreme shortage resulted in a high scarcity premium for many types of commodities and services quite frequently expressed in black market terms. At the end of the war, however, when the general public started to clamor for decontrol, my faith in the soundness of our dollar returned. I believe that its purchasing power will increase each year for at least the next ten as measured by the amount of commodities and services it will purchase.

Why this complete change in my thinking? I have always had more confidence in Adam Smith than I have had in many of the theories of the more recent econo-

mists. I am not convinced that "welfare economics" as advocated by many New Dealers will in the long run increase the standards of living or the general welfare of the masses of people in any country. In fact, I would go further in believing that a country adopting these policies will have lower standards of living after a number of years for the average worker than it would have in a freer economy.

In my opinion, the OPA was the greatest inflationary factor in the United States. In holding prices on many commodities below the cost of production with a reasonable profit, production stopped and scarcities became acute. No amount of legislation or demagogic cajolery could put meat on the butcher's counter when the price he was allowed to charge was insufficient to pay a fair return to the retailer, wholesaler, processor, and livestock producer. We were solemnly assured that the difficulty was an actual shortage of meat and that no amount of meat could be brought to the market by removing controls. Even the President of the United States was hoodwinked by his advisers and so informed the nation in one of his fireside chats. Just so soon, however, as controls were removed the fallacy of the high-spun theories was clearly demonstrated to the man in the street. Meat appeared in abundance and from that time to this it has been possible to get practically any type of meat at any time in practically any part of the United States.

I will grant that at the present time prices are high as a result of the financing of the war by increasing the amount of currency in circulation, because of the policy of selling government bonds to the commercial banks. This increased the amount of bank credit in exactly the same fashion that it would have increased had we actually financed the war by printing greenbacks.

In a relatively free market price increase can be due to several different reasons: 1. It can be due to a shortage of goods. If the demand for any article exceeds the supply, the price will rise until the increasing price will reduce the demand and the supply and demand will be equal. 2. It can be due to an increase in the supply of money and credit, because an increase of this sort increases the demand for almost all goods and services and unless the goods and services increase by the same percentage, prices will rise until the total price of all goods and services will again be equal to the total amount of currency and credit available for their purchase. 3. It can be due, and it was during the war period, to the combination of these two factors. Currency and credit was increased greatly while the supply of goods and services for sale to the public was sharply curtailed. The necessity of using a large part of our industrial capacity for the manufacture of goods never put on the market but used exclusively for war restricted greatly the physical volume available to purchasers. Until the war was over it was possible through rationing and price control to secure patriotic compliance and to conceal from the public the loss in purchasing power of the dollar due to the inflationary policies of the government. When the war was over, however, and black markets grew to the point where public disgust threw out ineffective controls, the dollar has been finding its actual value, and that value is considerably lower than the general public realized would be the case. Hence the complaint about high prices.

From here on out, however, the factors which control prices will, in my opinion, take a different course than the one they have followed in the period we have

just come through. We will have at least a semblance of a balanced budget with no necessity of financing future deficits through additional sales of bonds to the banks. The amount of bank credit in circulation will not expand as it did in the period prior to 1946. It will probably remain somewhat close to its present level. On the other hand, the supply of goods and services available for consumer purchase will increase rapidly during the next few years. It will be very easy, for instance, to grow more agricultural products than we can hope to use in our domestic economy with foreign markets severely restricted by fairly large crops abroad and by a lack of purchasing power to purchase our surpluses raised with high-price labor. These surpluses will be due to the use of better seed, better fertilizers, and the use of many labor-saving devices. Most cotton will in the relatively near future be picked by machinery, with the eventual possibility of a sharp reduction in the price of cotton. Corn, wheat and other grains have probably passed their peak price and from here on out the chief worry of the government will be the cost of maintaining the support levels for agricultural prices.

In manufacturing, unit labor costs are high but during the war industrial capacity was greatly expanded. Were there no accrued shortages at the present time, it would be very easy to produce in the United States more than our domestic markets could absorb and, again, foreign markets lack the purchasing power to buy our surpluses in large quantities.

During the past year our industrial plant has been used to fill the pipeline. In other words, when the war ended, dealers' shelves were bare and consumers had accrued demands which they had not been able to satisfy. As production got under way, it was used first to build necessary inventories for other producers, then to build up wholesale stocks, and finally to fill the shelves of retailers. During the initial period the extreme shortages of the war period took the goods off the retailers' shelves more rapidly than they could be replaced by the manufacturer, and many persons assumed that this rate of turnover could be continued indefinitely. Accrued demand was confused with recurring demand. During 1947, in my opinion, the accrued demand for consumer goods will be completely satiated and only the recurring demand will remain. The manufacturer will no longer be receiving orders to build inventories on the part of the wholesaler, the retailer or the consumer. His orders will represent only the amount necessary to replace goods actually sold currently. In some of the durable goods industries in 1947 this will not yet be the case and prices in these fields will show more resistance to decline than they will in the fields where production problems will give way to problems of merchandising.

Inflation has never yet run wild in an economy which could produce more than it could consume. Wild inflation must be accompanied by an incapacity to produce in quantity and every wild inflation has had this characteristic. Just so long as government controls prevented all-out production, there was grave danger in the United States that inflation might run wild, but the basic good sense of the American public has now removed that threat. It seems to me that increasing production will in a short time cause price levels to drop, not to their prewar level but to a level below the present high abnormal rate.

The increase in production from here on out should have the tendency of bringing continued price cuts during the next few years and with each additional

cut the purchasing power of the dollar will increase. At a time when dollars are increasing in value it is wise to have investments which will pay back at some future time a stated amount in dollars. A safe bond which agrees to return the principal in five to ten years with 3 per cent interest per annum will actually pay far more than 3 per cent from the standpoint of purchasing power. The principal finally repaid will have a purchasing power greater than the principal amount today, and when this capital gain in purchasing power is added to the amount received in interest, the result is quite favorable and quite different from the investment in good bonds during the period from 1939 to 1947. An investment in good bonds which paid 3 per cent per year probably had a negative rate of interest, as the decreased purchasing power of the principal more than offset the amount of interest paid.

It seems to me that the increasing purchasing power of money from here on out is changing the entire investment picture and the policies which succeeded in the inflationary period should now be changed to policies designed specifically to meet deflation. During an inflationary period slim equities were the best investments. During a deflationary period conservative short-term bonds and mortgages are far better.

Due to the fact that accrued shortages still exist in the durable goods field, I believe that there is yet some further inflation probable in office buildings, hotels and large apartments, but I think that deflation is now upon us in the values of single-family residences and many other types of real estate. This deflation will not be drastic but will be slow and certain.

Human nature is peculiar in that people will always buy with enthusiasm in a rising market but when trends change and prices start to drop, purchases will be deferred, with the expectation of buying at a lower level. A boom can collapse rather suddenly due to the change in the psychology of prospective purchasers, and it seems to me that this change is more or less inevitable among the buyers of real estate during the next few years. After the readjustment, however, there should be a period of several years at least when business and real estate will experience very good profits.

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